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SUBJECT: TURKEY'S ECONOMY MARCH 3 AM: GUL AND IMF STATEMENT
CONTAIN SELL-OFFS

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distribution.

1. (SBU) Summary: Early March 3 public statements by PM Gul, IMF Mission Chief and the Central Bank all helped contain market sell-offs on the morning of March 3. Some investors' hope that the parliament's decision might not be final also helped limit the damage. The good news is that the GOT and IMF reached agreement late March 2 on a 2003 budget that achieves a 6.5 percent of GNP primary budget surplus (however, the new measures are largely tax increases and not spending cuts). PM Gul said the GOT would submit the budget to the parliament March 3. Turkish Treasury has cash reserves of TL 4.2 quadrillion, so it can comfortably limit the March 4 T-bill bids to keep interest rates from going too high. As markets begin to refocus on Turkey's economic fundamentals, and carefully examine the 2003 budget assumptions, there will likely be renewed concerns over the 2003 financing gap. End Summary.

A Market Sell-Off is Contained

2. (SBU) Turkish financial markets opened March 3 sharply lower than Friday's close, but then recovered somewhat by noon (except the always volatile stock market), based largely on statements by PM Gul, IMF, Central Bank described below.

-- Yields on lira-denominated T-bills jumped at market opening to 62 percent in annually compounded terms, before recovering to 59.5 percent by mid-day. Turkey's 2030 maturity Eurobond followed a similar path, down 5 percentage points in early trading, before recovering to be down 3 percentage points at mid-day.

-- The lira depreciated 6 percent at market opening, reaching TL 1,675,000 to the dollar, before settling at TL 1,645,000 to the dollar at noon.

-- The Istanbul Stock Exchange 100 index was down 11 percent in morning trading.

3. (SBU) JP Morgan/Chase bond trader Sinan Gumisdis explained that the sellers were foreign hedge funds, though he added that some foreign funds were staying in and hoping that the GOT will submit a second troop deployment resolution to the parliament. "If the U.S. doesn't wait, or the GOT doesn't try again, then the markets will weaken further." Goldman Sachs Turkey analyst Buchanan agreed that some investors were still hoping parliament's March 1 vote was not final, and that the U.S. assistance package was not yet dead. Turkish banks, primarily Akbank, bought T-bills this morning, helping to limit the sell-off. In the currency market, Turkish corporate exporters sold dollars helping to contain the lira's depreciation.

The March 4 Auction

4. (SBU) Turkish Treasury Deputy U/S in charge of public finance Hakan Ozyildiz told us this morning that Treasury will go ahead with its March 4 T-bill auction as planned. As of Friday COB, Treasury's cash balance was TL 4.2 quadrillion, he said. The March 5 debt redemption totaled TL 3.9 quadrillion. Thus, Ozyildiz commented, Treasury could afford to limit the successful bids in the March 4 auction to keep interest rates as low as possible (informally, he believes Treasury will try to raise TL 2.5 quadrillion in the

auction).

PM Gul Shows Determination on Budget

15. (SBU) At 9:10 local time March 3, PM Gul held a press conference and read a televised statement flanked by Deputy PM Sener, State Minister Babacan, Foreign Minister Yakis, and Finance Minister Unakitan. Gul said the GOT would submit the full-year 2003 budget to parliament on March 3, and this budget exceeded the 6.5 percent of GNP primary surplus target. The highlights of the statement follow:

-- "Any development that might distort budget balances, including the primary surplus target, will be prevented. A healthy tax system, and increasing tax collections are vital to meet the primary surplus. In addition, there will not be any further tax amnesties or other reschedulings of public sector receivables. (Note: This is a commitment in the draft LOI which IMF staff insisted on, and which last week the GOT refused to commit to, per IMF resrep. End Note.)

-- "A direct tax reform bill will be sent to parliament soon."

-- "Our government believes in the independence to the Banking Regulatory and Supervision Agency (BRSA), and will continue to support BRSA actions." He added that banking sector reforms and restructuring will continue.

-- Privatization is at the top of our agenda. The privatization plan for TEKEL (state tobacco and alcohol company) will be submitted to the Higher Privatization Council in the coming days."

-- "A detailed timetable regarding redundant state enterprise employment will be announced."

-- Decreasing the inflation rate is also a top concern. The GOT together with the Central Bank have set an inflation target of 20 percent. The Central Bank will exercise monetary policy to achieve this target free of any political pressures.

New Fiscal Savings Measures in the Budget

16. (U) PM Gul also distributed a list of fiscal saving measures at the press conference, which incorporate measures previously announced together with new measures. (Embassy is obtaining the list and will report septel).

17. (SBU) IMF resrep told us March 3 that the new measures do result in a budget yielding a 6.5 percent of GNP primary surplus, per IMF calculations. The IMF and GOT broke the budget impasse at about 2:00 am March 3; the gap between the two had been 1.5 percent of GNP (about TL 5 quadrillion or \$3 billion).

-- The IMF had agreed to include in the budget the GOT-suggested measure of delaying into 2004 the 2003 "Direct Income Support" payments to farmers (worth TL 1.5 quadrillion or 0.5 percent of GNP). Comment: The World Bank is opposed to this measures because it guts a key agricultural sector reform, and thus may endanger disbursements of World Bank loans to Turkey. End Comment.

-- The GOT had come up with new tax increases - mainly a doubling of a special tax on vehicles and real estate tax increase (worth about TL 2.4 quadrillion or 0.67 percent of GNP.

-- The GOT had also come up with a series of new, but small expenditure cuts, the largest of which was additional cuts to public investment projects (worth about TL 1.1 quadrillion or 0.33 percent of GNP).

IMF Mission Chief Statement also Helps

18. (U) Shortly after PM Gul's televised statement on March 3, IMF Mission Chief Juha Kahkonen, in Ankara, released the following statement:

-- "The steps announced by the government are welcome. The budget, in particular, appears consistent with a primary surplus of 6.5 percent of GNP. Discussions are continuing on other aspects of the Fourth Review."

Central Bank Statement Provides Further
Confidence

19. (SBU) The Central Bank also released a statement at market opening March 3. Its warning of a possible intervention to address extreme exchange rate fluctuations was effective in dampening down lira sell-offs, per Bender Securities trader Murat Golkan. Central Bank market's department chief Ozcay told us at noon that the Central Bank had not intervened to date and didn't plan to do so. The statement reads in part:

-- "As a result of the parliament's decision on the subject of deploying Turkish and foreign troops to the border, fluctuations should be expected in the foreign exchange and interest rate markets.

-- "The Central Bank will closely monitor all market developments and, if needed, measures will be taken to help the markets functions effectively.... If there are extreme fluctuations in the exchange rate because of a drop in the market's liquidity or speculative moves that hurt stability, the Central Bank could intervene in the exchange rate from either direction."

Comment - 2003 Financing Gap

10. (SBU) As markets begin to refocus on the economic fundamentals, and carefully examine the 2003 budget, concerns over a 2003 financing gap are likely to re-emerge. The Turkish Treasury's financing assumptions for 2003 include an average interest rate on new TL borrowing of 45 percent for year. Interest rates need to start coming down soon, in order for the government's financing scenario to be credible.
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